



FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

5 CFR Part 1601

Mutual Fund Window

AGENCY: Federal Retirement Thrift Investment Board.

ACTION: Proposed rule.

SUMMARY: The Federal Retirement Thrift Investment Board (FRTIB) will make a mutual fund window available to participants in the Thrift Savings Plan (TSP), beginning in the summer of 2022. The FRTIB is proposing a fee designed to guarantee that the availability of the mutual fund window will not indirectly increase the share of TSP administrative expenses borne by participants who choose not to use the mutual fund window. The FRTIB is also proposing rules and procedures to govern fund transfers to and from the mutual fund window.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments using one of the following methods:

- Federal eRulemaking Portal: <https://www.regulations.gov>.

Follow the instructions for submitting comments.

- Mail: Office of General Counsel, Attn: Dharmesh Vashee, Federal Retirement Thrift Investment Board, 77 K Street NE, Suite 1000, Washington, DC 20002.

Comments will be made available to the public online at <https://www.regulations.gov>. Do not include any personally

identifiable or confidential information that you do not want publicly disclosed. Anonymous comments are acceptable.

FOR FURTHER INFORMATION CONTACT: *For press inquiries*, contact Kim Weaver at (202) 465-5220. *For information about how to comment on this proposed rule*, contact Laurissa Stokes at (202) 308-7707.

SUPPLEMENTARY INFORMATION: The FRTIB administers the TSP, which was established by the Federal Employees' Retirement System Act of 1986 (FERSA), Public Law 99 335, 100 Stat. 514. The TSP is a tax-deferred retirement savings plan for Federal civilian employees and members of the uniformed services. The TSP is similar to cash or deferred arrangements established for private-sector employees under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)). The provisions of FERSA that govern the TSP are codified, as amended, largely at 5 U.S.C. 8351 and 8401-79.

FERSA requires the TSP to offer the following individual investment funds to TSP participants: (1) a Government Securities Investment Fund (G Fund); (2) a Fixed Income Investment Fund (F Fund); (3) a Common Stock Index Investment Fund (C Fund); (4) a Small Cap Stock Index Investment Fund (S Fund); and (5) an International Stock Index Investment Fund (I Fund). 5 U.S.C. 8438(b)(1)(A)-(E). In addition to these five individual funds, the TSP is statutorily required to offer Lifecycle (L) Funds which are target retirement date portfolios comprised of varying proportions of the five individual funds. 5 U.S.C. 8438(c)(2). These statutorily mandated investment options are referred to as the TSP core funds. The FRTIB does not have discretionary authority to add or remove funds from its menu of core funds.

I. BACKGROUND

What is a Mutual Fund?

A mutual fund is a company that pools money from many investors and invests the pooled money in other investments such as stocks, bonds, and short-term debt instruments. Investors buy shares in mutual funds. Each share represents an investor's part ownership in the fund and the income it generates. Investors buy mutual fund shares from the mutual fund itself rather than from other investors. Mutual funds are governed primarily by the Securities Act of 1933, the Securities and Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisors Act of 1940.

What is a Mutual Fund Window?

A mutual fund window is a type of self-directed brokerage account that gives individuals the ability to buy shares of mutual funds through a broker-dealer that has been selected by their retirement plan or by one of their retirement plan's service providers. Unlike a plan's core funds, the investments available through a brokerage account are not ordinarily vetted by a plan fiduciary to determine whether they are prudent investments.

Authority to Offer a Mutual Fund Window

For many years, TSP participants have voiced a desire to have more investment options. A *2008 TSP Participant Survey* indicated that 39% of participants believed that the addition of a mutual fund window would improve the TSP.¹ In 2009, Congress passed

¹ Subsequent surveys have consistently reaffirmed these survey results.

legislation that authorizes, but does not require, the FRTIB to offer a mutual fund window to TSP participants. *Thrift Savings Plan Enhancement Act of 2009*, Pub. L. 111-31, Division B, Title I, sec. 104 (codified at 5 U.S.C. 8438(b)(5)(A)). Congress authorized a mutual fund window instead of adding more funds to the TSP's statutorily mandated menu of core funds.

Decision to Offer a Mutual Fund Window

In the same year that Congress authorized the FRTIB to offer a mutual fund window, the FRTIB's Executive Director initiated discussions with the FRTIB Board members and the Employee Thrift Advisory Council (ETAC) about adding a mutual fund window to the TSP.² In the April 2009 FRTIB Board meeting, the four Board members in attendance deadlocked on the decision to adopt a resolution in support of the mutual fund window by a vote of two-to-two.³

To inform future discussions, the FRTIB assembled a cross-functional team of subject matter experts from its operations, legal, investment, finance, communications, research, and technology offices who spent the next several years studying industry practices, participant preferences, costs, and operational considerations associated with adding a mutual fund window to the TSP. Their research was presented to the FRTIB

² ETAC is comprised of representatives from Federal and Postal unions and management associations, as well as a representative from the Department of Defense on behalf of uniformed service members. ETAC provides advice on matters relating to TSP investment policies and plan administration.

³ See April 2009 FRTIB Board Meeting Minutes, available at <https://www.frtib.gov/MeetingMinutes/2009/2009Apr.pdf>. Links to attachments accompanying the minutes are embedded in the PDF of the minutes.

Board members and ETAC during public meetings in May 2014, November 2014, and July 2015.⁴

In July 2015, the FRTIB Board members voted unanimously in support of adding a mutual fund window to the TSP. The FRTIB Executive Director committed to including a mutual fund window in the scope of services sought the next time the FRTIB recompeted its major service provider contract(s). In August 2019, the FRTIB announced the release of a request for proposals for various recordkeeping services, the scope of which included a mutual fund window. The contract was awarded in November 2020. The FRTIB is currently undergoing an 18-24 month transition to its new recordkeeping service provider.

II. NEED FOR REGULATION AMENDMENTS

Fees and Expenses

FERSA requires the Executive Director to publish regulations that "shall allocate to each account an amount equal to a pro rata share of the net earnings and net losses from each investment of sums in the Thrift Savings Fund attributable to sums credited to such account, reduced by an appropriate share of the administrative expenses paid out of net earnings under section 8437(d) of this title, as determined by the Executive Director." 5 U.S.C. 8439(a)(3). In addition, the Thrift Savings Plan Enhancement Act of 2009 added a provision to FERSA that requires

⁴ See May 2014 FRTIB Board Meeting Minutes, available at <https://www.frtib.gov/MeetingMinutes/2014/2014May.pdf>; November 2014 FRTIB Board Meeting Minutes, available at <https://www.frtib.gov/MeetingMinutes/2014/2014Nov.pdf>; July 2015 FRTIB Board Meeting Minutes, available at <https://www.frtib.gov/MeetingMinutes/2015/2015Jul.pdf>. Links to attachments accompanying the minutes are embedded in the PDFs of the minutes.

the FRTIB to "ensure that any expenses charged for the use of the mutual fund window are borne solely by the participants who use such window." 5 U.S.C. 8438(b)(5)(B). This proposed rule aims to fulfill these two Congressional directives.

Participants who choose to invest through the mutual fund window will incur fees and expenses that do not apply to participants who invest only in the TSP core funds. These fees and expenses fall into four general categories: (1) an annual maintenance fee of \$95, (2) a per trade fee of \$28.75, (3) fees and expenses imposed by the specific mutual fund(s) in which the participant chooses to invest, and (4) a fee designed to guarantee that the availability of the mutual fund window will not indirectly increase the share of TSP administrative expenses borne by participants who choose not to use the mutual fund window. The scope of this proposed rule includes only the latter category of fees and expenses.

Investment Elections and Fund Transfers

FERSA requires the FRTIB Executive Director to publish regulations governing investment elections and fund transfers. 5 U.S.C. 8438(d). Accordingly, the FRTIB is proposing to amend its regulations to include rules and procedures for transferring funds to and from the mutual fund window.

III. PROPOSED REGULATION AMENDMENTS

Administrative Expenses

Currently, all TSP participants bear a pro rata share of the TSP's administrative expenses. The TSP's administrative expenses are reflected as a reduction in the unit prices of the TSP core

funds. When participants begin moving assets from the TSP core funds to mutual funds, this method of allocating TSP administrative expenses will no longer be sufficient to ensure that all participants bear a pro rata share of the TSP's administrative expenses. The TSP has no control over the share prices of the mutual funds. Thus, this method cannot be used to allocate the appropriate share of TSP administrative expenses to assets invested through the mutual fund window. Failure to collect the appropriate share of TSP administrative expenses from assets invested through the mutual fund window would increase the share of TSP administrative expenses borne by participants who choose not to use the mutual fund window.

Therefore, the FRTIB is proposing to collect an annual fee of \$55 from mutual fund window users to guarantee that the availability of the mutual fund window does not indirectly increase the share of TSP administrative expenses borne by participants who choose not to use the mutual fund window. The amount of the proposed fee was derived by multiplying an assumed average mutual fund window account balance of approximately \$120,000 by an assumed TSP administrative expense ratio of 4.59 basis points. The FRTIB proposes to redetermine the annual fee every three years using the actual average mutual fund window account balance and expense ratio, as of the date of redetermination.

Minimum and Maximum Fund Transfers

The mutual fund window will allow access to funds that are not as diversified as the TSP core funds and therefore may expose participants to greater market risk. The mutual fund window is intended for TSP participants who are experienced investors. It

is not suitable for all TSP participants. While there may be legitimate reasons for a participant to invest in undiversified funds, such needs can be met through limited portfolio allocations. Because of the increased risk associated with the breadth of options offered through the mutual fund window, the FRTIB is proposing several restrictions on transfers and allocations between the TSP core funds and the mutual fund window.

First, the TSP is proposing to require an initial fund transfer of at least \$10,000 to the mutual fund window. Second, this initial investment may not cause the portion of the participant's TSP balance that is invested through the mutual fund window to exceed 25 percent of the participant's total TSP balance. These two restrictions, taken together, would require a participant to have a minimum TSP balance of \$40,000 before becoming eligible to invest through the mutual fund window. Third, subsequent transfers to the mutual fund window would be limited to amounts that do not cause the portion of the participant's TSP balance that is invested through the mutual fund window to exceed 25 percent of their total TSP balance.

Operational Details

To invest in mutual funds, a TSP participant must first establish a mutual fund window account that is separate from the portion of their TSP balance that is invested in TSP core funds. The FRTIB proposes the following rules and procedures:

1. *Elected Transfers.* A participant may elect to transfer money (in whole dollar increments only) from TSP core funds to a mutual fund window account. Amounts transferred to a

participant's mutual fund window account will initially be invested in a sweep money market fund. The participant may then choose from among the mutual funds offered. A participant cannot make contributions directly to a mutual fund account. All contributions must first be invested in the TSP core funds. Similarly, a participant cannot receive a withdrawal directly from a mutual fund window account. A participant who wishes to make a withdrawal election that exceeds the amount of their balance that is invested in TSP core funds must first transfer money (in whole dollar increments only) from their mutual fund window account back to the TSP core funds.

2. *Forced Transfers.* The FRTIB is sometimes required by law to make payments from a TSP account even when a participant has not made a withdrawal election. For example, the Internal Revenue Code requires the TSP to make minimum payments of a certain amount to participants who are age 72 years or older. For another example, the FRTIB is sometimes required to make payments under court orders that award benefits to a participant's spouse or child. Paragraph (c)(1) of the proposed regulatory text contains a non-exhaustive list of the types of payments that the FRTIB might be required by law to make from a participant's TSP account.

If the amount a participant has invested in TSP core funds is insufficient to cover a payment that the FRTIB is required by law to make, then the FRTIB will force a transfer from the participant's mutual fund window account to the TSP core funds. If the participant's mutual fund window account balance is at least \$25,000, the forced transfer amount will equal the amount

needed to cover the insufficiency plus \$1,000. The forced transfer amount will be liquidated first from amounts held in the sweep money market fund and then from amounts invested in mutual funds, beginning with the position with the highest balance. If the participant's mutual fund account balance is less than \$25,000, his or her entire mutual fund account balance will be transferred back to the TSP core funds. All forced transfers will be invested in the TSP core funds in accordance with the participant's existing contribution allocation. The participant will be responsible for any fees incurred as a result of the forced transfer.

3. *Monthly Transfer Limit.* Currently, participants are allowed two interfund transfers in a calendar month. After that, they can only transfer money into the G Fund. Any transfer from the TSP core funds to a participant's mutual fund window account, or vice versa, including a forced transfer, will count toward the existing monthly limit on interfund transfers. Consistent with current rules, a participant may always elect a fund transfer from his or her mutual fund window account to the G Fund.

4. *Acknowledgment of Risk.* FERSA requires any participant who elects to invest in "any investment fund or option other than the Government Securities Investment Fund", to sign an acknowledgment which states that the investment is made at the participant's own risk, that the participant is not protected by the Government against any loss on such investment, and that a return on such investment is not guaranteed by the Government. 5 U.S.C. 8439(d). The FRTIB is proposing to treat the mutual fund window as an "investment option" for purposes of this requirement.

Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities. This regulation will affect Federal employees, members of the uniformed services who participate in the TSP, and beneficiary participants.

Paperwork Reduction Act

I certify that these regulations do not require additional reporting under the criteria of the Paperwork Reduction Act.

Unfunded Mandates Reform Act of 1995

Pursuant to the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 602, 632, 653, and 1501-1571, the effects of this regulation on state, local, and tribal governments and the private sector have been assessed. This regulation will not compel the expenditure in any one year of \$100 million or more by state, local, and tribal governments, in the aggregate, or by the private sector. Therefore, a statement under 2 U.S.C. 1532 is not required.

List of Subjects in 5 CFR Part 1601

Government employees, Pensions, Retirement.

Ravindra Deo,

Executive Director,

Federal Retirement Thrift Investment Board.

For the reasons stated in the preamble, the FRTIB proposes to amend 5 CFR chapter VI as follows:

PART 1601 - PARTICIPANTS' CHOICE OF TSP FUNDS

1. The authority citation for part 1601 continues to read as follows:

Authority: 5 U.S.C. 8351, 8432d, 8438, 8474(b)(5) and (c)(1).

2. Add subpart F to read as follows:

Subpart F—Mutual Fund Window

Sec.

1601.51 Applicability.

1601.52 Fund transfers.

1601.53 Fees.

§1601.51 Applicability.

This subpart applies only to the transfer of amounts between the TSP core funds and the mutual fund window; it does not apply to the investment of future deposits, which is covered in subpart B of this part, or fund reallocations or fund transfers among the TSP core funds, which is covered in subpart C of this part.

§1601.52 Fund transfers.

(a) *Fund transfers to mutual fund window.* A participant may elect to make one or more fund transfers to the mutual fund window from the portion of his or her TSP balance invested in the TSP core funds, subject to the following rules:

- (1) The participant must establish a mutual fund window account that is separate from the portion of his or her TSP balance invested in the TSP core funds. A participant with more than one TSP account may establish a separate mutual fund window account for each TSP account, and the

limitations and fees described in this section will apply separately to each account;

(2) If the participant does not have an acknowledgment of risk on file as of the date of his or her initial fund transfer request to the mutual fund window, the participant must complete an acknowledgment of risk before the fund transfer can be processed;

(3) Fund transfers must be made in whole dollar increments (percentages are not permitted);

(4) The following limitations must be satisfied:

(i) A participant's initial fund transfer into his or her mutual fund window account must be at least \$10,000 and may not exceed 25 percent of the participant's TSP account balance, as of the date of such transfer; and

(ii) Subsequent fund transfers into a participant's mutual fund window account may not cause the balance in the participant's mutual fund window account to exceed 25 percent of the participant's total TSP balance, as of the date of any such transfer;

(5) Each fund transfer into the mutual fund window counts toward the monthly limit set forth in § 1601.32(b);

(6) Amounts transferred to a participant's mutual fund window account will initially be invested in a sweep money market fund. Subsequently, the participant may direct the investment of the transferred amounts into any mutual fund(s) that are available through the mutual fund window;

(7) Fund transfers are subject to the fees set forth in § 1601.53; and

(8) A participant may not withdraw funds directly from his or her mutual fund window account. To make a withdrawal, the participant must elect a fund transfer back to the TSP core funds as described in paragraph (b) of this section. Upon completion of such fund transfer, the participant may make a withdrawal in accordance with 5 CFR part 1650.

(b) *Fund transfers back to TSP core funds.* A participant may elect to make a fund transfer to the TSP core funds from amounts invested in his or her mutual fund window account, subject to the following rules:

(1) Fund transfers must be made in whole dollar increments (percentages are not permitted);

(2) Amounts to be transferred from a participant's mutual fund window account to the TSP core funds must first be transferred to the sweep money market fund. Subsequently, the participant may direct the investment of the transferred amounts into the TSP core funds;

(3) Each fund transfer back to the TSP core funds from the mutual fund window account counts toward the monthly limit set forth in § 1601.32(b); except, however, that a participant may always elect a fund transfer from the mutual fund window account to the G Fund; and

(4) Fund transfers are subject to the fees set forth in § 1601.53.

(c) *Forced transfers.* The TSP record keeper will force a transfer from the participant's mutual fund window account to the TSP core funds in the following situations, and subject to the following rules:

(1) A forced transfer may occur if the balance invested in the TSP core funds is insufficient to cover:

(i) Amounts necessary to comply with a court order, legal process, or levy described in 5 CFR part 1653;

(ii) A beneficiary asset transfer;

(iii) A required minimum distribution;

(iv) A distribution of an account balance less than \$200 described in 5 CFR 1650.23; or

(v) Any other payment or transfer that the Board is required by law to make from the participant's TSP account balance;

(2) The amount of the forced transfer shall be equal to the amount of the insufficiency described in paragraph (c)(1) of this section, plus \$1,000; except, however, that if the participant's mutual fund window account balance is less than \$25,000, the entire mutual fund window account balance shall be transferred to the TSP core funds;

(3) Forced transfers shall be liquidated from the participant's mutual fund window account first from amounts held in the sweep money market fund; and then from amounts invested in mutual funds, beginning with the position with the highest balance;

(4) Forced transfers from a participant's mutual fund window account to the TSP core funds shall be invested according to the participant's existing contribution allocation; and

(5) The participant shall be responsible for any fees incurred as a result of the forced transfer.

§1601.53 Fees.

(a) The Board will allocate a portion of the TSP's administrative expenses to mutual fund users by charging an annual fee of \$55.00. The amount of this fee will be redetermined once every three years by multiplying the average mutual fund window account balance by the TSP administrative expense ratio, as of the date of redetermination.

(b) The fee described in paragraph (a) of this section is in addition to any mutual fund window account maintenance fees, trading fees, and fees and expenses associated with the specific mutual fund(s) in which the participant chooses to invest.